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Supreme Court, U.S.
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No. 02-315

IN THE

Supreme Court of the United States

FRIEDMAN'S INC. D/B/A FRIEDMAN'S JEWELERS, AMERICAN BANKERS INSURANCE COMPANY OF FLORIDA, INC., and AMERICAN BANKERS LIFE ASSURANCE COMPANY OF FLORIDA,

Petitioners,

v.

STATE OF WEST VIRGINIA *EX REL.* JAMES DUNLAP,

Respondent.

On Petition for a Writ of Certiorari to the Supreme Court of Appeals of West Virginia

REPLY FOR THE PETITIONERS

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REPLY FOR THE PETITIONERS

1. **Introduction**. Respondent does not, and cannot, seriously dispute the central showings of the petition — the triple conflict created by the decision below (whether parties to an arbitration agreement may forgo class-action procedures as a matter of federal law; whether they may agree to forgo punitive damages as a matter of federal law; and whether Section 2 of the Federal Arbitration Act ("FAA") preempts state law regarding mutuality of obligation to arbitrate), or the importance and recurring nature of these questions to the effective use of arbitration to promote interstate and international commerce. *See* Pet. 7-21; *id.* at 22-25.

Rather, respondent opposes review on two grounds as incredible and breathtaking as the decision below — that "this case is not really about arbitration," and that there is no real conflict here because the decision below is state-law-dependent and "[n]one of the decisions from other jurisdictions cited by Petitioners involves determinations of West Virginia's state law of exculpatory clauses." Opp. 1-2. The former claim is belied by the decision itself, and the latter claim — that petitioners must show a conflict of *West Virginia law* to merit *U.S. Supreme Court review* — is a strategic misunderstanding of petitioners' showings, which demonstrate multiple conflicts of federal law.

Finally, respondent's repeated insistence that the decision below is "routine" (Opp. 13) and "straightforward" (Opp. 17) is truly remarkable. Trial Lawyers for Public Justice ("TLPJ"), which now represents the respondent, earlier described the decision as "groundbreaking" (*Court Throws Out Arbitration Clause With Bar on Class Actions*, June 17, 2002, http://www.tlpj.org/News_PDF/fall-02/06-17-02-adr.pdf) and as "send[ing] a powerful message to businesses." *West Virginia's Highest Court Holds That Arbitration Clauses Cannot Be Used to Eliminate Consumers' Rights*, http://www.tlpj.org/pressreleases/friedmans.htm. These non-

litigation-induced descriptions of the decision below are the more accurate ones, and show why certiorari should be granted.

2. **The Three Conflicts**. Respondent ignores many of the decisions that conflict with the decision below. In those few instances where respondent does try to harmonize the decision below with the numerous conflicting decisions of this Court and lower courts, he relies on immaterial factual distinctions or fundamentally misunderstands the reasoning employed in those decisions. Opp. 10-12, 13-16, 17-20, 22-24.

a. **The Punitive-Damages Conflict**. Petitioners showed (Pet. 11-15) that the decision below deepened an existing split of authority on the question of whether parties to FAA-covered arbitration agreements may agree to eliminate punitive damages liability. Respondent contends that "there can be no split of authority" because that question is a matter of "West Virginia state contract law." Opp. 9. This is a ***non sequitur***, as respondent later concedes by agreeing that a conflict might exist "to the extent that the FAA might ever be construed to preempt" that state law. Opp. 10. That is, of course, exactly the issue raised in the decision below, presented in the petition, and the subject of the conflict — whether state law or policy preferences favoring the imposition of punitive damages may be applied to invalidate an FAA-covered arbitration agreement in which the parties agree to forgo such damages.

When respondent does attempt to explain away the conflict of authority, his arguments fail. He contends that petitioners "have identified no authority that conflicts with the West Virginia Supreme Court's decision." Opp. 12. Yet, respondent makes no attempt to harmonize the decision below with directly conflicting decisions of the Fourth, Fifth, Eighth, Ninth, and Tenth Circuits or with contrary decisions of the Second Circuit and Illinois Supreme Court, all of which were cited in the petition. Pet. 12-15.

Respondent does address three of the conflicting decisions, where he asserts that decisions of the First, Seventh, and Eleventh Circuits may be reconciled on the "factual circumstance[]" that each involved challenges to an arbitrator's decision to award punitive damages. Opp. 10-11. That factual distinction is immaterial. Each of these decisions plainly holds that the availability or absence of punitive damages in arbitration is, as a matter of federal law, governed by the parties' agreement, not by individualized state laws or policies. *See Davis v. Prudential Sec., Inc.*, 59 F.3d 1186, 1189 (11th Cir. 1995); *Baravati v. Josephthal, Lyon & Ross, Inc.*, 28 F.3d 704, 709 (7th Cir. 1994); *Raytheon Co. v. Automated Bus. Sys., Inc.*, 882 F.2d 6, 12 (1st Cir. 1989). Similarly unavailing is respondent's statement that these decisions relied on federal law "rather than state law." Opp. 11. In fact, this purported distinction only confirms the error of the decision below and the split of authority it engenders: Federal law provides that, ***under the FAA***, parties may contract for the availability or absence of punitive damages, contrary state law or policy preferences notwithstanding.

Finally, respondent's attempt (Opp. 16) to minimize the conflict with *Mastrobuono v. Shearson Lehman Hutton, Inc.*, 514 U.S. 52 (1995), is ineffectual. As explained in the petition (Pet. 11-12), *Mastrobuono* approved an argument that, under the FAA, "the parties to a contract may lawfully agree to limit the issues to be arbitrated by *waiving* any claim for punitive damages" just as they may "agree to *include* claims for punitive damages within the issues to arbitrated." 514 U.S. at 58 (first emphasis added). Either way, "the FAA ensures that their agreement will be enforced according to its terms." *Id.* Furthermore, respondent's contention that *Mastrobuono* "did not involve a generally applicable body of state law, such as that applied by the court below" (Opp. 16) is demonstrably wrong. In fact, as the Court noted in the first sentence of its opinion, "New York law" of punitive damages,

which supplied the backdrop to the arbitration agreement at issue, "allows courts, ***but not arbitrators***, to award punitive damages." 514 U.S. at 53 (emphasis added). Nonetheless, despite state law precluding the award of punitive damages by arbitrators, the Court held as a matter of federal law that the "FAA ensures that [the parties' arbitration] agreement will be enforced according to its terms" (*id.* at 58) and found that, in the agreement at issue, "the text of the arbitration clause itself surely does not support — indeed, it contradicts — the conclusion that the parties agreed to foreclose claims for punitive damages." *Id.* at 61.*

b. **The Class-Action Conflict**. Petitioners also showed (Pet. 8-11) that the decision below created a split of authority on the question of whether an arbitration agreement may be invalidated on the ground that it does not provide for class-action procedures.

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* Respondent's repeated suggestion (Opp. 11-12, 15-16) that the decision below is consistent with decisions of this Court stating that arbitration clauses must allow parties to "effectively vindicate" statutory rights is both irrelevant and wrong. It is irrelevant because, as the court below expressly stated, the only statutory right at issue in this case is under the West Virginia Consumer Credit & Protection Act, which does not contain a statutory entitlement to punitive damages. Pet. 14 (citing Pet. App. 26a n.8). Thus, the West Virginia legislature has already conclusively decided that punitive damages are not necessary to "effectively vindicate" any right under the Act. Respondent's contention that this Court's precedent establishes a well-settled and absolute bar to the waiving of certain remedies in arbitration agreements is also wrong. In fact, the Court recently granted certiorari in *Pacificare Health Systems, Inc. v. Book*, 123 S. Ct. 409 (granted Oct. 15, 2002), to determine the validity of an arbitration agreement that did not allow an arbitrator to award punitive damages for RICO violations. *See* Pet. for Cert., *Pacificare Health Sys., Inc. v. Book*, S. Ct. No. 02-215 (granted Oct. 15, 2002), at i. Although *Pacificare*, unlike this case, involves no question of state-law policy preferences (nor, for that matter, does it involve questions of purported class-action or mutuality rights), the Court's decision in *Pacificare* may nonetheless shed significant light on the question of whether, and to what degree, parties may waive statutory or other remedies in an arbitration agreement.

Respondent contends (Opp. 17-18) that the invalidation of the arbitration agreement on this ground was "straightforward" and created no conflict of authority. Neither contention is correct. As noted at p. 1, above, TLPJ has itself described the decision on this issue as "groundbreaking." And indeed it is. Respondent has not cited a single case in which a federal court of appeals or state court of last resort has issued a similar decision. Instead, respondent offers two cases that, by his own admission, concern forum-selection clauses, not arbitration clauses. Opp. 17. The relevance of these cases is neither evident nor adequately explained.

Respondent then adds the further, incongruous arguments that there is no conflict of authority because decisions cited in the petition reaching "opposite conclusions . . . reflect[] a difference between varying law of exculpatory clauses in different states," and because the petition cites "a great many cases that do not involve state law unconscionability issues." Opp. 17-18. The first argument, which is unburdened by authority, is wrong. Even a cursory examination of the conflicting cases cited in the petition demonstrates that each held, ***as a matter of federal law***, that parties to an FAA-covered arbitration agreement may agree to preclude class actions. Pet. 9-11. The second argument is (again) a ***non sequitur***. Respondent (again) admits that a conflict of authority may be found if the "FAA somehow preempts substantive state contract law." Opp. 18 n.2; ***see id.*** at 12. But (again) this is exactly the issue raised by the decision below and presented in the petition — whether state law favoring class-action proceedings may be applied to invalidate an FAA-covered arbitration agreement in which the parties agree to forgo such procedures.

Respondent's attempt (Opp. 18-20) to sweep away ***Gilmer v. Interstate/Johnson Lane Corp.***, 500 U.S. 20 (1991), likewise fails. It is true that ***Gilmer*** involved a dispute under the Age Discrimination in Employment Act of 1967. But that decision

expressly rejected the very argument that respondent relies upon — that the absence of class-action procedures would prevent "adequate" enforcement of legal rights. *Id.* at 32. Moreover, respondent shows no awareness of the inconsistency of his and the West Virginia court's positions — his contention (Opp. 19-20), embraced by the court below (Pet. App. 27a), that his claims are too monetarily slight to be effectively vindicated absent class-action procedures cannot be reconciled with the court's rejection of his argument that the cost of arbitrating his claim is prohibitive. Pet. App. 32a-37a. This inconsistency in reasoning and result further confirms the West Virginia courts' hostility to arbitral fora and its intent to foil arbitration agreements on any (and all) conceivable grounds.

Respondent is, at least, honest about his position — he says that state law may, consistent with the FAA, require arbitration contracts to include a term that "explicitly permits consumers to bring appropriate claims on a class action basis." Opp. 19. But respondent seems unaware that this requirement impermissibly takes aim at arbitration *qua* arbitration — arbitration is, by definition, *not* court litigation. As the Seventh Circuit has held, a stipulation "that disputes will be submitted to arbitration" inherently requires relinquishment of "certain procedural niceties which are normally associated with a formal trial." *Champ v. Siegel Trading Co.*, 55 F.3d 269, 276 (7th Cir. 1995). One such procedural nicety is the "possibility of pursuing a class action" (*id.*), something the *Gilmer* Court plainly understood in its refusal to invalidate an arbitration agreement that did not provide for class-action procedures. *See* 500 U.S. at 32 (by definition, arbitrations are "individual attempts at conciliation"). A state-law requirement that arbitration agreements provide class procedures would strike at the heart of the FAA's aim of overcoming "suspicion of arbitration as a method of weakening the protections afforded in the substantive law to would-be complainants." *Rodriguez de*

Quijas v. Shearson/American Express, Inc., 490 U.S. 477, 481 (1989).

Finally, review here is needed because the decision below is already being used as a wedge to widen the newly-created split of authority. In *Leonard v. Terminix International Co.*, No. 1010555, 2002 WL 31341084 (Ala. Oct. 18, 2002) — decided after the petition was filed — a deeply divided Alabama Supreme Court relied on the decision below to hold that an arbitration agreement precluding class-action procedures was unenforceable. *Id.* at *6-*8. The court so held despite acknowledging that such a result was in marked tension with this Court's precedent (*id.* at *5) and despite prior Alabama Supreme Court cases suggesting a contrary result. *See id.* at *11 (Woodall, J., dissenting); Pet. 10-11. This Court's immediate review is necessary to prevent any further widening of the rift and concomitant diminution of the effectiveness of arbitration agreements.

c. **The "Mutuality" Conflict**. Petitioner further showed (Pet. 15-20) that the decision below deepened a split of authority on the question of whether the FAA preempts state law concerning mutuality of obligation to arbitrate. Respondent says (Opp. 20) there is no conflict. Respondent is wrong. There is a deep, and long-standing, split on this issue that requires this Court's attention.

Respondent again contends that the decision below merely represents a "routine application" of "generally applicable state contract law principles." Opp. 20-21. It does not. Respondent's selective quotation of *Arnold v. United Companies Lending Corp.*, 511 S.E.2d 854 (W. Va. 1998), omits the key passage relied on by the court below:

> Where an ***arbitration agreement*** entered into as part of a consumer loan transaction contains a substantial waiver of the borrower's rights, including access to the courts, while preserving the lender's right to a judicial forum, the agreement

> is unconscionable and, therefore, void and unenforceable as a matter of law.

Id. at 862 (emphasis added; cited at Pet. App. 31a n.12). On its face, therefore, the voiding rule employed by the court below is directed to arbitration agreements specifically, not to contracts generally — which runs directly contrary to numerous decisions of this Court. *See* Pet. 6-7, 16-17.

Furthermore, respondent's insistence (Opp. 22) that "differences in outcome in the state and federal court cases cited by Petitioners are based entirely on variations in state contract law" is demonstrably wrong.

None of the conflicting decisions issued by state courts of last resort was based on state-law grounds. In ***Ex Parte McNaughton***, 728 So. 2d 592 (Ala. 1999), the Alabama Supreme Court expressly held that any invalidation of an arbitration agreement on mutuality-of-remedy grounds "flies in the face of [***Doctor's Associates, Inc. v. Casarotto***, 517 U.S. 681, 687 (1996)], . . . where the Supreme Court of the United States explicitly stated that '[c]ourts may not . . . invalidate arbitration agreements under state laws applicable only to arbitration agreements.'" *Id.* at 598-99. Thus, on its face, the *McNaughton* holding turns on federal law and an express rejection of contrary state law. The South Carolina Supreme Court's decision in ***Munoz v. Green Tree Financial Corp.***, 542 S.E.2d 360 (S.C. 2001), expressly relied on *McNaughton*'s reasoning to reach the same result. *Id.* at 365. *Munoz*'s only mention of state law concerning mutuality was an aside after the court had grounded its holding in federal law. *Id.* Finally, in ***In re FirstMerit Bank, N.A.***, 52 S.W.3d 749 (Tex. 2001), the Texas Supreme Court expressly rejected cases holding that state law of mutuality of remedy may void arbitration contracts (*id.* at 757 & n.34) in favor

of the "weight of federal precedent" holding to the contrary. *Id.* at 757-58 & n.35.

Respondent's attempt to harmonize conflicting federal decisions fares no better. In *Wilson Electrical Contractors, Inc. v. Minnotte Contracting Corp.*, 878 F.2d 167 (6th Cir. 1989), the Sixth Circuit rejected any mutuality-of-obligation prerequisite to enforcing an arbitration agreement, expressly basing that rejection on this Court's decision in *Prima Paint Corp. v. Flood & Conklin Manufacturing Co.*, 388 U.S. 395 (1967), not upon Ohio's (or any other state's) contract law. *See* 878 F.2d at 169. Any other result, the court held, would reflect "the old judicial hostility to arbitration." *Id.* Likewise, as respondent concedes (Opp. 23), the Third Circuit in *Harris v. Green Tree Financial Corp.*, 183 F.3d 173 (3d Cir. 1999), expressly held that "*substantive federal law* stands for the proposition that parties to an arbitration agreement need not equally bind each other with respect to an arbitration agreement if they have provided each other with consideration beyond the promise to arbitrate." *Id.* at 180 (emphasis added). It is true, as respondent states (Opp. 23), that the *Harris* court, like the South Carolina court in *Munoz*, made a "reference to state law" after reaching this conclusion. But in context, it is plain that this "reference" was only that. The decision rested on federal-law grounds.

3. **The Importance of the Issues**. TLPJ was correct when, prior to being retained to author the Brief in Opposition, it described the decision below as "groundbreaking" and "send[ing] a powerful message to businesses." *See* p. 1, above. Unfortunately, the "powerful message" that the decision below sends is that any arbitration agreement that deviates in any way from the full panoply of procedures and remedies available in judicial proceedings will be unenforceable in West Virginia. Pet. App. 14a-16a n.3. This "judicial hostility to arbitration agreements" (*Gilmer*, 500 U.S. at 25), of course, strips them of

their core value — prompt, inexpensive, and uniform resolution of disputes. *See* Pet. 23. (Were there any doubt about the West Virginia court's raw hostility to arbitration, it would be eliminated by the court's almost-but-not-quite holding that arbitration agreements are unconscionable deprivations of the right to jury trials, *see* Pet. App. 21a-25a; Pet. 20-22 n.4.)

And, as demonstrated in the petition, the result of this hostility will be to push more disputes back into overloaded judicial systems and to impede interstate and international commerce. Pet. at 22-24. Indeed, notwithstanding respondent's claimed concerns about ***de minimis*** claims being left unlitigated (Opp. 17), it is certainly the case that wide-ranging class litigation such as that sought by respondent will cost companies like Friedman's far more in litigation costs and potential punitive awards; the result of such increased transactional costs will be an increase in consumer prices — most likely in excess of the amounts that respondent claims to have been deprived. *See, e.g.*, S. Ware, ***Paying the Price of Process: Judicial Regulation of Consumer Arbitration Agreements***, 2001 J. Disp. Resol. 89, 93-100. But Congress, in the FAA, already balanced these policy choices in favor of arbitration and commerce, not in favor of litigation and trial lawyers.

These unfortunate consequences of the decision below, none of which is challenged by respondent, are antithetical to the FAA's "declared . . . national policy favoring arbitration." ***Southland Corp. v. Keating***, 465 U.S. 1, 10 (1984). This Court should grant certiorari to resolve these issues on a national basis.

CONCLUSION

For the foregoing reasons, as well as those stated in the petition, certiorari should be granted.

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